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H FOR CODEL LOWEY

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SUBJECT: SCENESETTER FOR CODEL LOWEY

¶1. (SBU) Summary: You will arrive in a Peru relatively well-positioned to deal with the unfolding global economic crisis but deeply concerned about its longer-term implications. Thanks to several recent policy successes and a tactical shift to the left, President Garcia's nation-wide poll numbers have risen to nearly 30%. Peru's weak state institutions limit the government's ability to deliver the kinds of public services people expect and to address key structural challenges such as drug trafficking and terrorism. U.S.-Peru ties have rarely been better, anchored in free trade, long-standing counter-narcotics cooperation, a good security relationship and a broadly shared world view. Welcome. End Summary.

¶2. (SBU) Peru finds itself facing the same heavy global cross-winds that are buffeting the world. Many analysts believe Peru is relatively well-positioned to weather the storm -- with high liquidity, low debt and little exposure to the core structural causes of the crisis -- and its projection for growth this year (4-5%) remains the highest in the region. But few argue Peru's relative economic stability means the country is in the clear, and local confidence has been further shaken with each successive wave of troubling news. For example, the price of commodities, which still make up over 60% of the country's export earnings, have plummeted since the onset of the storm. Peru's small stock market has dropped sharply also. Some large companies have begun payroll cuts and lay-offs, and some multinationals are rethinking their long-term investment strategies. Even Peru's remittance earnings have fallen somewhat. In responding to this challenge, the Garcia government has designed a public stimulus plan whose launch will be calibrated to the crisis's direct and likely increasing impact on Peru.

¶3. (SBU) Thanks to several recent policy successes and a greater focus on social priorities, President Garcia's nation-wide poll numbers have risen from below 20% in October to nearly 30% in January. The government's relatively favorable economic positioning, its successful organization of two major international meetings in 2008 (the European Union-Latin American country summit in May, and the APEC summit in September), and the entry into force of the long-awaited U.S.-Peru Trade Promotion Agreement (PTPA) have contributed to this rise. Some analysts believe the dip in inflation -- one cause of his earlier lower numbers -- has also played a role. Garcia's recent shift is reflected in

the choice as PM in his new cabinet of Yehude Simon (the popular former regional president of Lambayeque who embodies a left-of-center, social democratic political philosophy), in events with a broader public, and in his periodically announcing high-profile public-works projects -- water, roads, energy -- in poorer areas throughout the country.

¶4. (SBU) Peru's weak state institutions limit the government's ability to deliver the kinds of public services people expect. This challenge is particularly worrying in politically vulnerable regions where the state is largely absent and the "anti-system" opposition is strong. The government has sought to counter this problem with policies relating to streamlining public service entities, increasing spending on social services, and decentralizing key state functions to regional and municipal governments. The results of these policies have been mixed. In the case of decentralization, for example, much has depended on the quality of local leadership, the administrative capacity of sub-national governments, and the resources available to the region through royalties on mining and other natural resources.

¶5. (SBU) Peru's governmental challenges have also complicated Garcia's ability to confront Peru's profound structural challenges - including drug-trafficking and the remnants of the terrorist group Sendero Luminoso (Shining Path). Nonetheless, Garcia's government has made a serious effort to combat drug-trafficking in cooperation with the United States and other countries. Internally, the government places emphasis on interdiction and eradication, the latter of which has been directly linked to alternative development. While entrenched pockets of coca cultivation persist, the strategy of closely linking eradication with alternative development has had significant results in the Upper Hualлага Valley. Externally, the GOP most recently reached out to Mexico during the APEC leaders' meeting to enhance counternarcotics cooperation, signed an agreement with Thailand on alternative development, and has been working with Colombia on its shared responsibility initiative. The involvement of Shining Path (SL) remnants in drug trafficking, whether as facilitators or direct participants, continues to present a particular challenge for Peru's security forces. The Army launched a long-delayed operation to challenge remnants of the (SL) terrorist group on their home turf in the emergency VRAE region, but the longer-term results of this operation remain unclear.

¶6. (SBU) U.S.-Peru ties have rarely been better, and even Peruvian government officials have publicly stated they are the best in living memory. According to opinion surveys, the U.S. has a broadly positive image and enjoys considerable reserves of public sympathy in Peru. The comprehensive and intensive bilateral relationship is anchored in free trade -- the PTPA went into force February 1, to the great relief of Peruvian officials and general satisfaction of the informed public. In addition to the solid counternarcotics cooperation noted above, we have expanded our political-military relationship, with bilateral humanitarian exercises, support for Peru's expanding Peace Keeping Operations capabilities and, potentially, demining work along the Ecuadorian border. Most importantly perhaps, positive relations are rooted in intensive people-to-people ties -- close to one million Peruvian nationals live in the U.S. -- and a broadly shared world view in which regional and global opportunities and threats match closely.

¶7. (U) We look forward to your visit.  
MCKINLEY